THE DANA VIEWPOINT

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Dow: 16,433

(Not) Free Enterprise

China is getting its first real taste of the free enterprise system (a free market capitalist system). After more than a decade of double digit growth, their economy finally hit a speed bump. According to Chinese officials their economy is growing at a 7% annual clip. However, there is no real way to verify that and it is probably less considering the measures the government has been taking such as:

1) Devaluing the currency (yuan) to pump up exports
2) Attempting to stop short selling in their stock market
3) Lending more to banks who are told to encourage investors to borrow and buy common stocks
4) Telling their bigger stock brokerage firms and mutual funds to buy stocks

This is not free enterprise. This is big government trying to control the economy and the stock market. This does not work as we found out in the 1930's and since 2008 (more on that later). These actions will only delay the recovery. It is best to let the markets sort themselves out as they all do eventually. In the meantime, China is causing chaos by devaluing the yuan to make their products cheaper. Other countries are certain to follow and we will have currency wars all over again. In addition, cheaper prices will raise fears of deflation worldwide, just when our own Fed is trying to promote inflation. Inflation is easier to handle than deflation (refer to Germany in the 1930's). China is a big country and if their government doesn't interfere too much they will recover.

So are China's problems causing the volatility in our stock market? Undoubtedly that is part of the reason. However, we should look at the Federal Reserve's policies since 2008, the peak of our own financial bubble. Our recession ended in June of 2009. The stock market actually bottomed out in March of that year. The stock market leads. It is very smart. Since that time one of the Fed's objectives was to drive down interest rates to make money attractive to business so they would borrow and create jobs. Another objective, but less discussed, was to bring long rates down to push investors out of bonds and into equities. This would push equity prices up and create a wealth effect. Investors would feel good about stock market gains and would spend money on consumer goods. As retail sales are projected to be about 70% of GDP, this would push our economy forward. It worked. As investors couldn't find decent yields on bonds, they flocked to common stocks, especially dividend stocks at first.

The stock market was off and running and six years later we were looking at 18,000 on the Dow Jones Industrial Average. Recently, some panic set in culminating in an opening drop of 1,000 points on the Dow on August 24th. The Dow subsequently dropped to 15,500 then rebounded to 16,500 and is currently trying to find a bottom around 16,000. The Dow can move 300 points up or down in a flash. There is now a certain amount of fear in the marketplace. If left alone, it will sort itself out and at some point stocks will move from weak hands to strong hands. Right now psychology

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is controlling investors' decision making process. Old timers will tell you that these types of stock markets are controlled by greed, hope, and fear. First greed drives prices up to levels in excess of value. Early 2000 was a classic example when technology stocks were trading on earnings projections into the hereafter. When the selling started, panic set in and then there was hope that stocks would rise to a level that investors could get out even. Prices then dropped so far that fear set in and the weaker hands sold while the stronger hands bought and fundamentals resumed their priority. This is not to say that this is a full-fledged bear market, but there is enough fear and panic around to make this a nasty correction, albeit a much needed one.

The Fed's accommodative policies pretty much predetermined that the market would go to excessive levels and have a shake out. There is another Wall Street axiom that says "Never try to catch a falling safe". Let it bounce a few times. When the bouncing is finished, the direction of the market can be better judged.

The Fed meets September 16-17 and investors are speculating whether they will raise interest rates or not. To further cloud the Fed's judgement, the jobs report was announced last Friday. After three consecutive months where the private sector created over 200,000 new jobs, August came in with a disappointing 173,000 new jobs. The unemployment rate dropped to 5.1%, a level that in the past the Fed would consider full employment. However, most people know by now that the government does not consider people who are not employed but not looking for work as unemployed. That drops more than a million people out of the calculation. The Fed prefers the employee participation rate, and that number is 62.6%, near the lowest level since 1977. As the Fed continues to follow the 19 economic indicators on its dashboard, you have to wonder if anyone is driving the car. The Fed should raise rates so we can move to a more normal economic environment. The rest of the world may not like it as it makes our stocks and bonds even more attractive. A stock market correction and an increase in interest rates equals a good tonic for our economy.

Random Thought for September 2015 The inherent vice of capitalism is the unequal sharing of the blessing. The inherent blessing of socialism is the equal sharing of misery.

-Winston Churchill

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